

SJR

9

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Alaska Permanent Fund Corporation

Financial projections FY 2009 - FY 2018

All amounts in millions, except per person dividend

Status Quo - Current Statutes	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY09-FY18 Totals
Contributions & appropriations (principal)	30,865	31,979	32,774	34,006	35,622	37,296	39,021	40,817	42,667	44,572	\$ 44,572
Unrealized appreciation/depreciation on assets balance	(5,766)	(3,573)	(1,737)	(166)	1,202	2,421	3,520	4,523	5,451	6,323	\$ 6,323
Realized earnings account (after payouts)	1,261	0	0	0	237	486	831	1,263	1,779	2,377	\$ 2,377
Total market value end of year (after payouts)	26,361	28,406	31,036	33,840	37,060	40,203	43,372	46,603	49,898	53,272	\$ 53,272
Total lump sum dividend appropriation	967	561	188	254	79	422	651	862	1,059	1,244	\$ 6,289
Per person dividend under current statutes	\$ 1,512	\$ 845	\$ 244	\$ 345	\$ 68	\$ 593	\$ 933	\$ 1,238	\$ 1,516	\$ 1,771	\$ 9,066
Inflation proofing transfer to principal	1,141	561	188	591	953	998	1,044	1,092	1,142	1,193	\$ 8,905

POMV - 5% (beginning FY2010)	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY09-FY18 Totals
Total market value end of year (after payouts)	26,361	28,130	30,097	32,264	34,649	37,242	39,991	42,920	46,022	49,303	\$ 49,303
5 year average market value lagged one year	N/A	33,488	33,183	32,649	31,495	31,148	33,286	35,657	38,234	41,014	
POMV 5% spending limit	N/A	1,674	1,659	1,632	1,575	1,557	1,664	1,783	1,912	2,051	
Total lump sum dividend appropriation (50% of POMV)	967	837	830	816	787	779	832	891	956	1,025	\$ 8,721
Per person dividend under POMV	\$ 1,512	\$ 1,287	\$ 1,260	\$ 1,225	\$ 1,166	\$ 1,139	\$ 1,207	\$ 1,282	\$ 1,363	\$ 1,449	\$ 12,893

Percent of Market Value

Assumptions:

1. FY 2009 includes actual results through January 2009, and effective 0% returns for the remainder of the fiscal year.
2. FY 2010-2018 based on 2008 Callan Capital Market Assumptions with total returns of 8.05% per year, and 20% asset turnover.
3. POMV calculation based on 5% of the average of the market values of the Fund on June 30 (pre-payout) for the first five of the six fiscal years immediately preceding that fiscal year.
4. POMV assumes a payout of one-half of POMV spending limit of 5% for Permanent Fund Dividends only.
5. POMV assumes that the remaining funds available for spending which are not used for dividends, stay within the Fund and are not appropriated for other purposes.
6. Contributions to principal are based on Department of Revenue's Spring 2009 Revenue Forecast.
7. Status quo does not allocate unrealized gains/losses to the realized earnings account, which could further limit the dividend payout.

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Permanent Fund yesterday

- 25% of mineral revenues go in the Permanent Fund
- Fund principal is invested and may not be spent
- Fund income goes to the General Fund

The Law

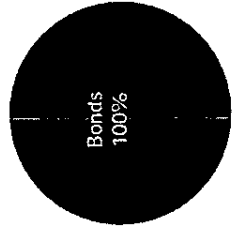
- At least 25% of mineral revenues go in the Permanent Fund
- Fund principal is invested and may not be spent
- Fund income is retained in the earnings reserve and is available for spending by the Legislature

Permanent Fund today**Permanent Fund under 5% limit**

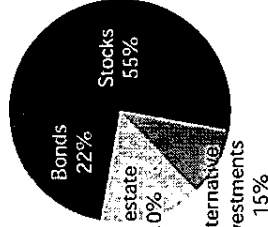
- At least 25% of mineral revenues go in the Permanent Fund
- Constitution is amended create a single Fund, without a distinction between principal and earnings
- Spending is limited to no more than 5% of the Fund's value

Investments

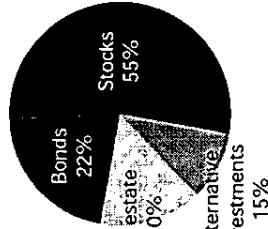
- All of the Fund's income is from bond interest
- All income is in the form of realized income



- Bonds and real estate produce realized income
- Stocks, real estate and alternative investments produce unrealized gains in value



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- Stocks, real estate and alternative investments produce unrealized gains in value



- Payout is based on realized income
- Payout is compatible with the income produced by Fund investments
- All income goes to the General Fund

Payout

- Payout is based on realized income
- Payout is incompatible with some of the income produced by Fund investments
- Income goes to the Earnings Reserve and is available for spending by the Legislature

- Payout is based on total Fund value
- Payout is compatible with all of the income, both realized and unrealized, produced by Fund investments
- Spending is limited to no more than 5% of the Fund's value

Inflation protection

- Constitution and statutes do not include inflation proofing

- Statutes direct that the principal of the Fund be protected from inflation

- Constitution provides for automatic inflation proofing over time through the 5% spending limit

Senate Finance Committee

March 12, 2009

Dividend Stabilization Plan

“To benefit all generations...”

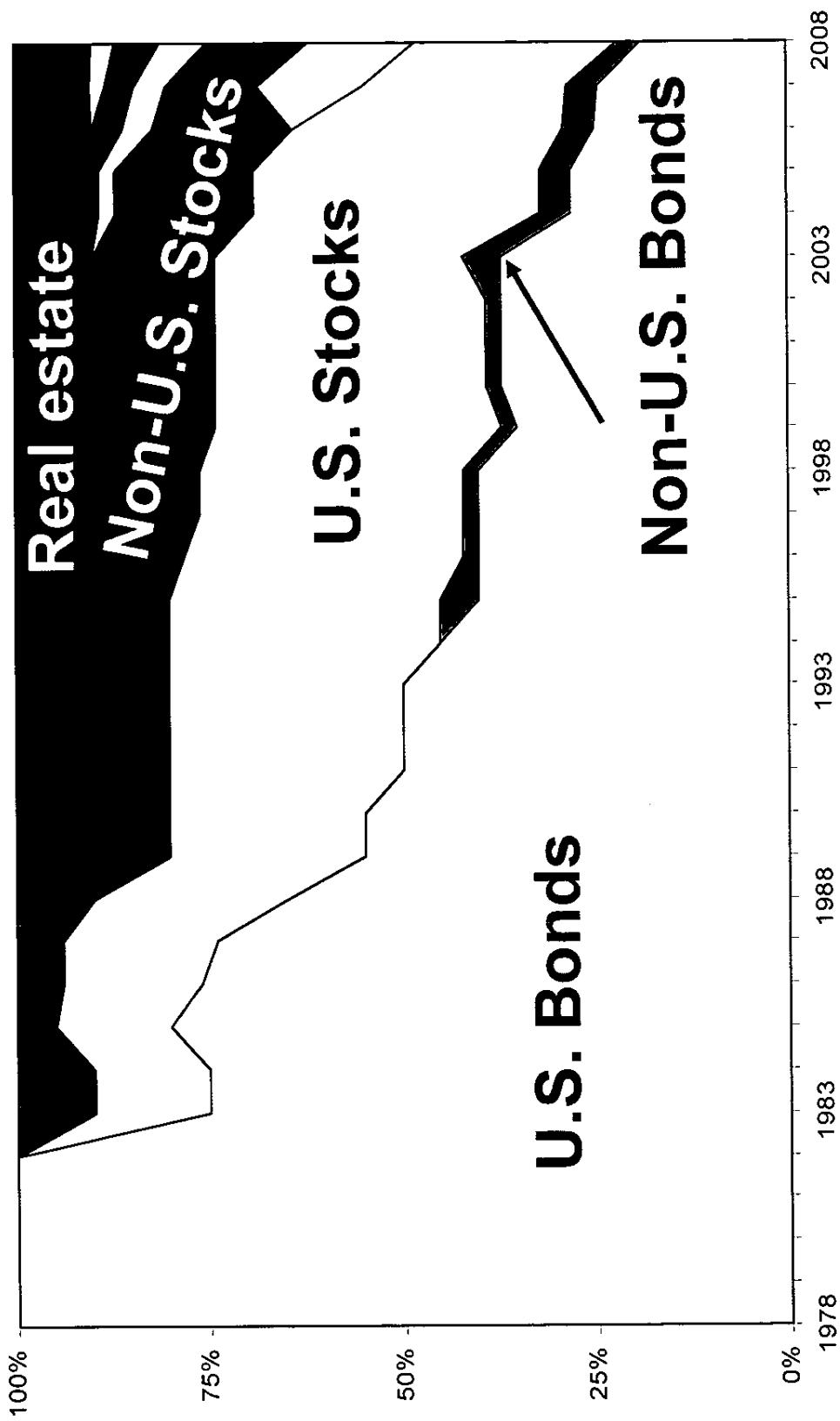
AS 37.13.020 (1)

...the Fund should provide
a means of conserving a portion
of the state’s revenue from mineral resources
to benefit all generations of Alaskans.

Is the Fund broken?

- Only part of the Fund is protected from inflation.
- The Fund's long-term investment strategy conflicts with its realized earnings-based payout policy.
- The Fund can't assure payouts in bad years.
- The Fund can be overspent in good years.
- The size of payouts is unpredictable and unstable from year to year.

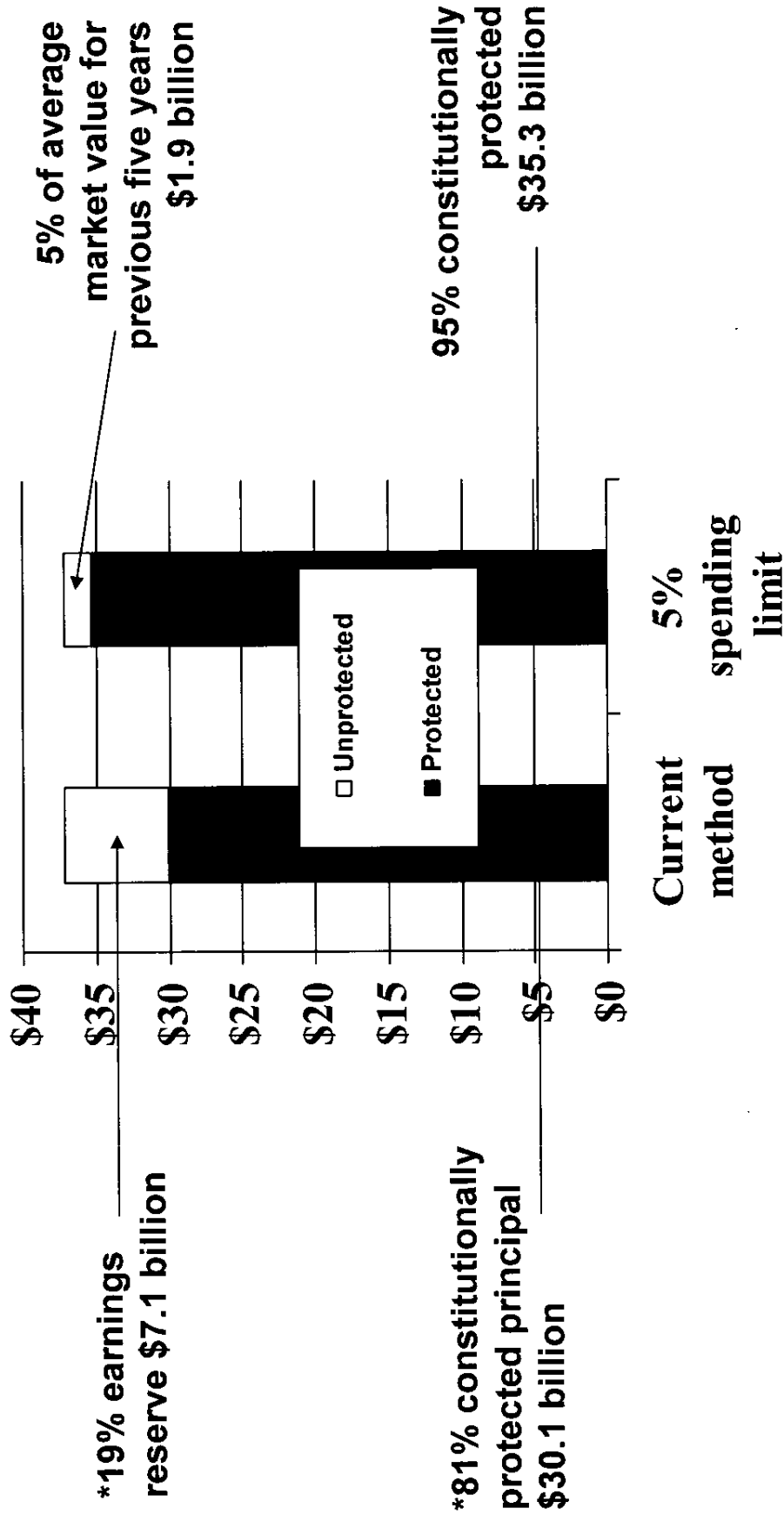
Asset allocation over time



The dangers of overspending

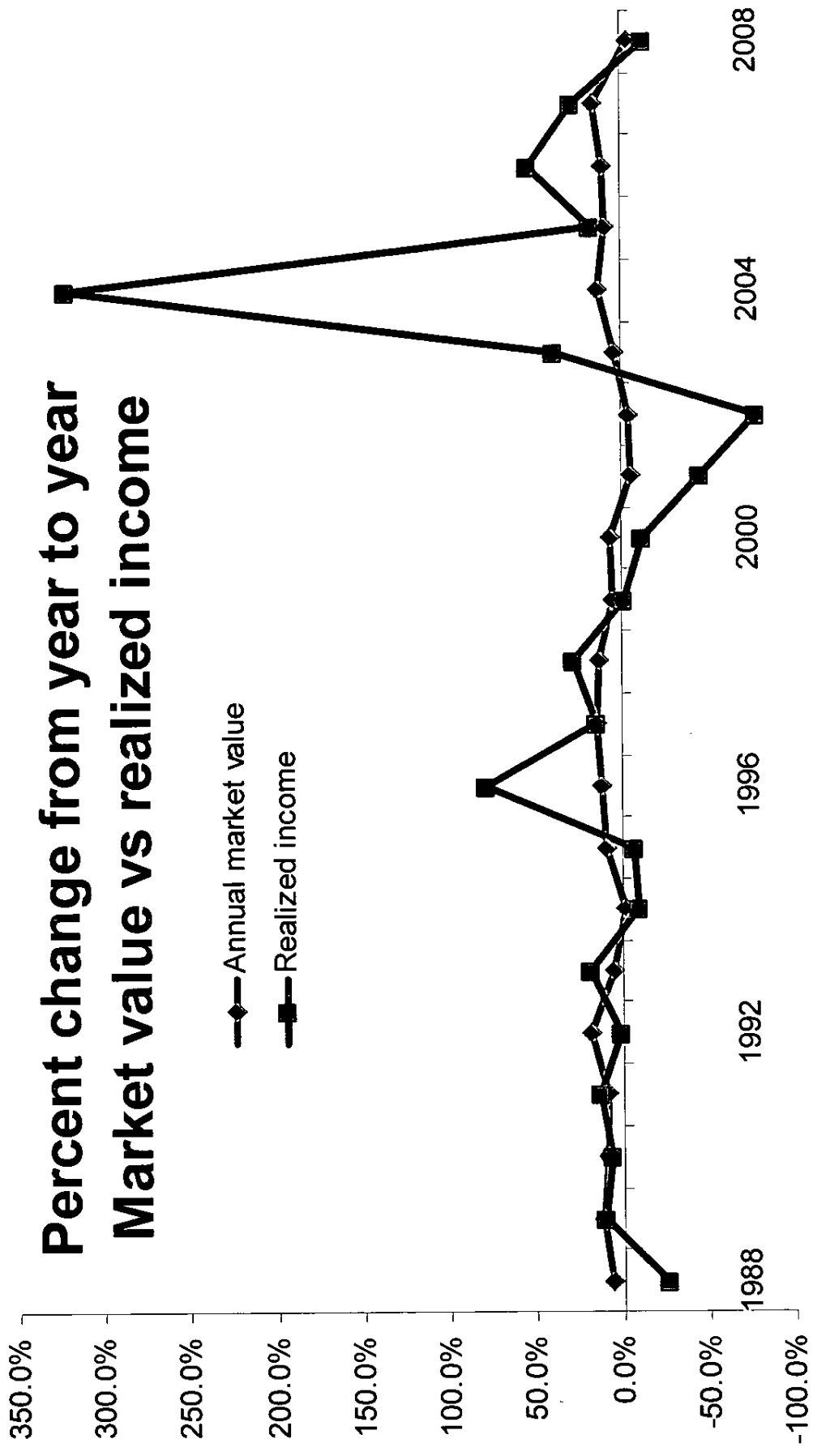
- **Overspending in good years means there will be no cushion for down years.**
- **Overspending can decrease a fund's benefit to future generations.**

FY 2008 comparison



* Values as of June 29, 2008 and do not reflect \$1.3 billion PFD payment or \$808 million inflation proofing transfer from earnings reserve to principal.

Payout source volatility



What is the answer?

Changing the spending limit for the Permanent Fund to an endowment-like payout method based on market value.

Under the dividend stabilization plan, no more than five percent of the Fund's market value may be withdrawn each year.

Under the current system, all realized earnings are available for spending from the Fund.

How it works

8% Projected average annual return

- 3% Projected average annual inflation

5% Maximum annual payout



Retained in Fund for inflation-proofing

Is it really 5%?

<u>Year</u>	<u>Value</u>	
1	\$30 billion	
2	\$31 billion	\$1.6 billion = 5%
3	\$32 billion	of five year average
4	\$33 billion	(\$32 billion)
5	\$34 billion	
Current	\$36 billion	\$1.6 billion = 4.4%
Year		of current fiscal year (\$36 billion)

Who uses this payout method?

- Anchorage, Fairbanks, North Slope Borough and Sitka residents voted to limit spending based on a percent of the market value of municipal trust accounts.
- Private foundations are required by the IRS to pay out at least 5% of their market value.
- 83% of college and university endowments use a payout method based on a percent of their market value.

ALASKA STATE LEGISLATURE

SENATE FINANCE COMMITTEE

Senator Bert Stedman, Co-Chair
State Capitol, Room 516
Juneau, AK 99801-1182
(907) 465- 3873 - Phone
(907) 465-3922 - Fax
Senator_Bert_Stedman@legis.state.ak.us



Official Business

Senator Lyman Hoffman, Co-Chair
State Capitol, Room 518
Juneau, AK 99801-1182
Phone - (907) 465- 4453
Fax - (907) 465- 4523
Senator_Lyman_Hoffman@legis.state.ak.us

SPONSOR STATEMENT

SJR 9 – PERMANENT FUND DIVIDEND STABILIZATION

When the Permanent Fund was created, its investment authority was restricted to one asset class, a bond only strategy. Income was generated by dividends received and by capital gains from bonds sold at appreciated prices. Since that time, the Fund's asset allocation now incorporates a broader mix of asset classes which seeks to maximize return while minimizing risks. This strategy, while offering higher returns, also increases the volatility of the Fund. Furthermore, it exposes the Fund, during times of financial distress, to valuation swings that are detrimental to the dividend payout.

Most trustees and managers of private and public funds see it as their fiduciary duty to use the real return formula which is simply the total return minus inflation; paying particular attention to maintaining their purchasing power over time. As opposed to the real return concept, the Permanent Fund uses its own archaic method of calculating its distribution formula.

- First, the accounting net income is calculated by subtracting operating expenses and any legislative appropriations from the total return of the Fund.
- From the accounting net income, unrealized gains or losses are subtracted or added which results in the realized net income.
- From the realized net income, the Amerada Hess realized income is subtracted, thus arriving at the statutory net income.
- The statutory net income is the amount used in the distribution formula.

This method of calculating the distribution of dividends leads to increased volatility and risk to the dividend during times of economic stress.

SJR 9 poses the question to legislators whether to allow Alaskans to decide if management of the Alaska Permanent Fund should be modernized to incorporate a more simplified approach. If adopted by the voters in the 2010 general election, the constitutional amendments in this joint resolution would change the way in which amounts available for appropriation from the Permanent Fund are determined. The Legislature could appropriate an amount that would not exceed five percent of the average market value of the Permanent Fund over the first five fiscal years of the six years immediately preceding the fiscal year in which the money is appropriated.

This approach stabilizes the dividend payout and would still allow a distribution to the Legislature as the current method does. Also it would protect the fund from inflation and allow the fund to grow. SJR 9 does not allocate the amount available for appropriation for a specific purpose.